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C O N F I D E N T I A L SECTION 01 OF 02 BEIJING 001523

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E.O. 12958: DECL: 06/08/2029

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SUBJECT: CONGRESSMEN KIRK AND LARSEN'S MEETING WITH CHINA
INVESTMENT CORPORATION

Classified By: Economic Minister Counselor Robert S. Luke. Reasons 1.4
(b/d).

¶1. (C) Summary. Recent economic trends in the U.S. are encouraging and there is no longer a "scare factor" for investors, China Investment Corporation (CIC) (China's sovereign wealth fund) President Guo told Representatives Kirk and Larsen May 31. CIC intends to increase its investments in the U.S. despite "significant concerns" about the U.S. security review process (CFIUS), Guo said. CIC has approximately \$100 billion invested in Chinese financial institutions and another \$110 billion in cash that it is seeking to invest. Guo said the Federal Reserve Bank's recent purchase of U.S. treasuries was "unconventional" and many Chinese bloggers believe the U.S. is sacrificing its largest creditor, China, to save itself. Guo maintained more transparency is not possible for large investors such as CIC due to the potential to move markets. CIC is concerned about the long-term possibility of inflation in the U.S. and its potential to devalue China's dollar-denominated holdings. End Summary.

¶2. (C) Representatives and co-Chairmen of the U.S.-China Working Group Rick Larsen (D - WA) and Mark Kirk (R - IL) on May 31 discussed the global financial crisis with China's sovereign wealth fund (SWF), the China Investment Corporation (CIC), President Guo Xiqing. Congressman Larsen, describing the current state of the U.S. economy, said the U.S. model of reliance on easy credit and the housing market for economic growth will have to change. China's reliance on exports will also have to change, but the sustainability of easy credit and fixed asset investment that is currently driving China's economy is questionable, Larsen maintained.

The "Scare Factor" is Gone

¶3. (C) CIC's Guo stated recent trends in the U.S. economy are encouraging and his organization intends to increase its investments there. The U.S. has the largest and most dynamic economy in the world, Guo said, and now the "scare factor" is gone. When the U.S. economy was looking particularly bleak, his analysts considered investing in Europe, but were not convinced about the prospects there. They also considered investing in emerging markets, he said, but finding large enough investment opportunities proved difficult.

¶4. (C) Guo said the CIC was established in September 2007, had an asset allocation plan by March 2008, and was ready to begin investing in June 2008. Amid increasing concerns about the international economic situation, however, CIC moved very slowly into the markets. As a result, CIC now finds itself in a much better position than many other SWFs, Guo bragged. Currently, CIC has approximately \$100 billion invested in Chinese financial institutions and \$110 billion in cash and cash equivalents that it is seeking to invest, he said.

An "Unconventional" Approach

¶5. (C) Representative Kirk inquired about Guo's view on the U.S. Federal Reserve Bank's recent buying of U.S. treasuries.

Guo replied that he believed this to be very "unconventional" but that perhaps, from the U.S. perspective, it made economic sense. Many Chinese bloggers, however, believe that the U.S. is sacrificing its largest creditor, China, to save itself. Guo stressed the importance of frequent, high-level communication between the U.S. government and the Chinese government to create predictability in the markets. Without predictability, the two sides would end up in a prisoner's dilemma, Guo suggested.

¶6. (C) Representative Kirk asked whether CIC has considered coordinating with other SWFs. Guo responded that representatives from Norway, Canada and other SWFs have discussed coordinating with CIC but he does not trust this approach. Each fund has its own bureaucracy, its own personalities and, as such, Guo does not believe coordination could work. (Note: Guo did not comment on the Santiago Principals for SWFs).

The Three Nos

¶7. (C) Asked whether CIC has specific policies guiding its investments, Guo said CIC Chairman Luo Jiwei had outlined the "three NOs" for investments - No weapons (except for limited military-related industry with dual use) , No gambling, and No tobacco. Otherwise, fund managers are free to invest as they see fit.

And No to Full Transparency

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¶8. (C) Representative Kirk stated the National Committee on United States - China Relations was founded after the Chinese National Offshore Oil Company (CNOOC) bid for Unocal in 2005 was denied based on Committee on Foreign Investment in the U.S. (CFIUS) concerns. The group's goal is to help lawmakers and others understand the U.S. - China economic relationship.

He suggested that, if CIC could be more transparent in its transactions, particularly for investments in the U.S., it may quell fears regarding the Chinese government's involvement in and intentions for those investments. Guo explained he knows many in the U.S. and other countries believe SWFs are the "weapons" of foreign governments trying to gain illicit control of strategic economic entities. However, no large investor would be willing to share with others what they are doing for fear of moving markets, he said. CIC will issue an annual report sometime after June which will have general statistics but nothing too specific, Guo stated. In fact, CIC is completely independent of the Chinese government, Guo maintained, insisting Chinese leaders provide no guidance and apply no pressure on the fund. CIC, however, is required to report its investments to the State Council. Guo noted that on one occasion, this was done just eight hours before closing the deal. According to Guo, CFIUS is still a "significant concern" for CIC.

¶9. (C) Asked for his views on the Chinese economy, Guo said China is still in the process of reforming its economy and the global economic crisis has provided a big opportunity to reform. There is, however, some danger of reverting back to a paternalistic, command economy as many of China's top leaders were raised in that tradition. Guo feels the macrotrend is still towards reform and that Chinese lawmakers are generally making the correct policies.

Inflationary Concerns

¶10. (C) Guo said he is concerned about the long-term possibility of inflation in the U.S., adding that with the Treasury "printing so much money" it is "inevitable" there will be inflation in the two-to-three year timeframe. CIC invests for the longer time horizon and so must consider this

possibility, he said. The Chinese government is in a dilemma, however, because if it tries to minimize risk by selling its dollar-denominated holdings now, this could negatively impact the U.S. economy. If it waits to sell, inflation may devalue those holdings. Officials from both countries need to discuss how to solve this issue, Guo suggested.

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